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THE RHODESIAN JOURNAL *of* ECONOMICS

The Journal of the Rhodesian Economic Society

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THE NEW JOURNAL

The Rhodesian Economic Society was founded in 1949 to promote interest in economic matters with an emphasis on Rhodesian problems. The Society has a wide membership of business men, financiers, civil servants and academic economists and its deliberations have accordingly been general and of wide interest.

It was only in 1959 that the Society brought together the various papers delivered to the Society meetings in a volume of Proceedings. Eleven volumes have since been published though the circulation of these Proceedings has been largely confined to Society members.

In keeping with its original objectives the Society has felt the time has now come to replace the Proceedings with a Journal which should become a quarterly with wider circulation. The Journal is not intended to appeal only to the specialist reader but to all interested in the Rhodesian economy. In addition to technical studies, it will publish articles of general economic interest. For this reason extracts from speeches and addresses that reflect and record development within Rhodesia will also be included.

Although the main body of the Journal will reproduce papers read to the Society, written contributions on economic topics are welcome.

The Rhodesian Economic Society is grateful for the financial support provided by a number of firms and other organisations without which the Journal could not be published.

EDWARD OSBORN,

President,
Rhodesian Economic Society.

THE GROWTH OF BANKING AND FINANCIAL INSTITUTIONS[1]

G. H. M. BEAK

The development of banking and financial institutions generally throughout the western world can best be understood by regarding banks essentially as an industry providing services to the community in which it is established and of which it forms a part.

Banking services are strongly influenced by the whole economic environment in which the banks operate. Changes therein—whether these are cyclical fluctuations in the economy or structural changes—create the need for the banks to adapt themselves to the new situation.

In this paper I wish to confine myself to structural changes only. These I propose to examine as a reflection of broad economic changes.

Industrial Revolution

Our starting point must be the middle of the 19th century, when the industrial revolution really got under way, first in Britain, then in other countries. This transformed the whole nature of the production process.

The first change was the replacement of the small industrial craftsman by the manufacturer. The former maintained close personal touch with his customers, and his work had a highly individualistic character. By contrast, the manufacturer produced on a much larger scale, in anticipation of demand.

The second change, arising from the first, was that competition became keener. Thus the cost aspect of the production process assumed overriding importance, and this very need to reduce overheads produced a strong incentive to increase turnover. Mass production was therefore adopted on an increasingly wider scale. With this came the perfection of manufacturing techniques and scientific research to improve the product's acceptability to the

1. *Paper read to the Society in April 1967.*

consumer. In sum, production became increasingly capitalistic. As the small producer disappeared, he was replaced by large combines, growing in size, influence and importance. The technological age had made its debut, with the concentration of production in a relatively few hands.

With these developments, the personal link between producer and consumer largely disappeared. Thus came the third change in the production process, the emergence of wholesaling and retailing as basic functions in the marketing of an increasing flow of merchandise of ever greater diversification. The distributive trade, like manufacturing, was profoundly influenced by the growth of competition. The main evidence of this was the introduction of new selling techniques and an interlinked pattern of structural and organisational changes.

Many small traders, who like individual craftsmen had served the needs of a small circle of personal customers, were driven out of business or absorbed by large distributive undertakings. Others survived only by adapting themselves to the new circumstances, for instance by forming voluntary association with each other, or with their suppliers. Later came a tendency to integrate the wholesale and retail functions. Manufacturers, in turn, tried to re-establish direct contact with consumers by means of product differentiation, brand advertising, and so on.

The struggle for survival, under these fluid conditions, has become intense. Constant adaptation to change has become a basic essential in providing a worthwhile product or service. Only those willing to accept this challenge can hope to remain in business. It is true of course that sometimes these changes occur slowly, and are not easily perceptible. But surely the ultimate test of good entrepreneurship is the ability to recognise the signs in good time, and to anticipate the future.

These major developments in production and distribution have obviously had far-reaching financial implications. Most important, the finance requirements of the business community grew considerably, both in volume and variety. Financial resources, therefore, had to be mobilised to the maximum, and channelled in the necessary directions.

Rôle of the Banks

In this process, the commercial banks, already well-established as traditional sources of credit, came to play a prominent part. As banking business became increasingly complicated and diversified, the commercial banks increased their range of services tremendously. Operations became highly mechanised and, as had occurred in production and distribution, the small type of banking house gave way to the bigger financial institutions.

At first, the commercial banks aimed primarily to provide temporary accommodation, to finance the movement of goods in national and international trade and the marketing of crops. These loans, of the so-called self liquidating type, were usually effected through the medium of the trade bill. More recently however, most bank lending has taken the form of overdrafts. Overdrafts are withdrawable on demand, but despite this formal appearance of liquidity, they are difficult to recall at short notice, on a large scale. This is especially true in times of national financial stringency.

Rapid industrialisation has had a further important result. It has created increased capital intensity of production, and the need for investment to be larger and for longer periods than in the past. As a result, the scope, nature and duration of bank finance has changed.

Today, it serves a variety of purposes. In particular there is a shift towards the provision of working capital for industrial enterprises. At the same time there is a tendency for finance to be sought for longer periods than previously. This lengthening of lending periods is noticeable in all industrial countries and goes hand in hand with increasing efforts by banks to attract time deposits—to match longer-term lending with longer-term funds.

Competition between banks has increased in the field of borrowing as well as lending. In countries where the old established institutions such as the commercial banks could not satisfy the demand for new forms of credit—for example consumer loans or medium term industrial finance—new types of financial institutions came into being, including those specialising in hire-purchase finance, industrial credit, leasing, etc. In other countries again, new needs were satisfied by existing financial institutions adapting themselves, or establishing subsidiaries for these purposes. With the increasing volume of monetary transactions systems of payment were improved. Cheque handling was computerised to a large extent, while other methods of payment avoiding the actual use of cash, such as those through post office giro clearing systems, were introduced in several countries. Credit cards, particularly in the United States, came into wide use, enabling customers to pay their accounts once a month by having their banks accounts debited without having to send out numerous cheques to individual creditors.

It is worth noting that developments in the financial sphere were not restricted to the banking sector. Due to industrialisation, the urbanisation of the population and rising standards of living, the demand for social security increased, thus institutional investors such as insurance companies and pension funds came to play a larger rôle in attracting the small man's savings, and building societies and savings banks also assumed a prominent rôle. Existing investment trusts made considerable headway and new ways of attracting savings, e.g. open trusts, were devised. These developments had an influence on banks, particularly savings banks, and other established institutions such as building societies. In many countries the changes in the banking structure were recognised by the authorities, and the legal framework concerning financial institutions was revised accordingly.

Against this background of general economic changes and adaptations to them of the banks, I wish to describe briefly the banking situations in various countries.

United States of America

In the U.S.A., financially and economically the strongest western country, banks differ considerably from the British and, for that matter, the Rhodesian concept. For instance, many American banks are directly engaged in hire purchase and mortgage finance. They have no country-wide branch system, due to the fact that the establishment of branches is legally restricted. The number of banks is, therefore, very large—in fact over 13,000! Normally, American banks do not lend on an overdraft basis, but provide customers with a loan. Interest is charged on the whole amount of the loan, irrespective of the amount taken up.

Commercial banks in the United States have for some considerable time extended their activities into medium and even long term finance. Term loans, as they are called, of up to eight years were introduced as a direct result of industry's demand for medium term accommodation instead of normal short term bank assistance. Information on term loans of all commercial banks is not available, but in 1965 these accounted for over 60% of all business loans at major New York City banks. Other important types of loans are consumer instalment and real estate loans, which were 14.4% and 24.5% respectively of total commercial bank loans in mid-1965.

In order to meet these longer-term demands for financial accommodation by the public it is but natural that the American banks have sought to an ever increasing extent, moneys of a more stable character such as time deposits. The noticeable shift towards longer term borrowing by American banks is evidenced by the fact that from 1960 to the third quarter of last year time deposits advanced by nearly 115% to 149 billion dollars. This contrasts with an increase of 12% in demand deposits to 128 billion dollars in the same period. At the end of last year the balance sheet of one of the large American banks showed demand deposits of 7.4 billion dollars, while time saving deposits stood at 4.1 billion dollars.

There is of course keen competition to attract the "savings" dollar, and commercial banks regard savings and loan associations and credit unions as their main competitors. The strength of this competition is shown by the fact that time deposits with savings institutions, over the period 1960 to the third quarter of last year, increased by about 70% to 175 billion dollars. American banks pay as much as 4% on savings accounts. The rate of interest on time as well as on savings deposits is pegged by official regulation and at the moment New York banks, for example, pay 5% on consumer savings certificates up to 100,000 dollars.

Early in 1961 one of the leading New York banks introduced the issue of "negotiable certificates of deposit". These, because of their ready marketability, are intended to appeal especially to corporate institutions in competition with other negotiable instruments such as treasury bills.

This idea caught on rapidly. Within six years—by mid February 1967—negotiable certificates of deposit with the principal commercial banks in major cities in denominations of 100,000 dollars or more, on which the banks are permitted by regulation to pay a maximum interest of 5.5%, amounted to some 12 billion dollars.

Due partly to the acquisition of more stable funds in the form of savings and time deposits, the American banks have increased their loan deposit ratio considerably over the ten year period ended 1965, from about 45% to roughly 63%. It is noteworthy that, in the same period, the ratio of interest-bearing deposits to demand deposits (on which the U.S. banks are prohibited by regulation to pay interest) rose from 1 to 3 to nearly 1 to 1.

There is an important and growing trend for American banks to establish offices in foreign countries, or to participate in foreign banks. This has no doubt been influenced by the strong flow of American investment capital after the war to overseas countries, and by the increasing amounts of business capital invested in the rapidly expanding European Common Market. American banks, particularly the New York giants, have also, in post war years, made large scale investments in certain foreign countries by providing through their foreign offices, medium and long term loans for capital and industrial development. This policy started in Japan where the American Government encouraged the provision of finance by the banks to build up the Japanese economy after the war. The American banks found this business to be highly remunerative. It also gave them their first real opening into international banking and they took the maximum advantage of the opportunities offered. So much so that a few years ago the American government was forced to limit the banks' investments in foreign countries by the well known Johnson 105% guide line.

American banks' overseas investments also include the provision of finance for jet aircraft fleets, and large scale industrial development in less developed countries. A large amount of business has also been gained by the American banks in the provision of export finance for American goods.

Another interesting aspect of American banking is their personal loan system which is unique in that the United States is the only country in the world where personal loans have really been successful.

It will be seen from what I have already said that in the U.S.A. the commercial banks, by virtue of their comprehensive coverage of all types of financial needs of the economy, from personal loans to long term financing of industry, have obtained a monopoly in the financial field and thus there has been relatively little scope for the development of other financial institutions. Furthermore where these do exist they are inclined to be controlled by the banks themselves so closely that they are virtually departments of the banks.

WESTERN EUROPE

Germany

It is of course well known that German banks, by tradition participate on a large scale in the provision of finance to industry, also in the form of medium term and long term loans. About five years ago, Germany introduced a new law on the credit system. This established "norms", and specified in great detail the maximum allowable ratio of advances to the various types of credit moneys attracted by the banks. Long term loans are separately classified, but no distinction is made between "normal" advances in the form of overdrafts and medium term loans.

Competition for deposits is keen, particularly between the two largest types of German credit institutions, the commercial banks and the savings banks.

It is interesting to note the strong relationship between the banks and the stock exchanges in Germany. Only banks are allowed to trade on the stock exchanges and, consequently they derive a considerable part of their profits from commission earned on stock and share dealings.

The commercial banks, moreover, own very substantial shareholdings in industrial, mining and commercial enterprises. The balance sheet of one of the leading German banks reveals a holding in shares quoted on the stock exchange, of D.M. 353m., which compares with a surplus in the form of capital and reserves, in accordance with the banking law, of D.M. 520m.

As in the case of the United States, time deposits with all commercial banks in Germany over the last few years have risen more rapidly than demand deposits. The latter, in the period 1960 to the second quarter of the last year, increased by just under 60% to 41 billion D.M., while time deposits advanced by some 190% to 126.7 billion D.M. and now account for about 75% of total deposits.

Traditionally, the German banks have always performed the functions of issuing and underwriting shares. More recently, however, they have increased their range of services by personal loans (mainly to finance the purchase of durable consumer goods) and property administration.

In Germany, in contrast to the situation in the United States of America and Britain, the cheque is not the main method of making payments. This function is chiefly performed by the giro systems of the Post Office, the savings banks and the large banks. Under this system the debtor advises his bank of the amount he wishes to pay, giving the name of the creditor and his bank, whereupon the amount is transferred from one account to the other through a central clearing institution. This method of payment is also used in quite a number of other European countries.

Belgium

In Belgium, over the last few years, time deposits rose more steeply than demand deposits. The Belgian banks also issue cash bonds for periods of three to five years, of which in September last year, 11.7 billion francs (about £84m.) was outstanding. Due to this relative increase in longer term resources Belgian banks have been able to lengthen the terms of credit extended by them to business.

Sweden

In Sweden the banks traditionally engage in longer term financing and play an important rôle in mortgage lending. Of the total amount of commercial bank advances, those to industry account for about 30%, those to commerce by 25% and those for housing some 24%. It is no coincidence in the Swedish banking system that time and savings deposits represent about 80% of total deposits.

Netherlands

In the Netherlands, savings accounts and time deposits form nearly 60% of total deposits of the commercial banks, while lending based on fixed loans for medium terms has increased in recent years. Most of the commercial banks' medium term finance is done by fully owned subsidiaries.

Personal loan business was started by two large Dutch banks in 1958. As in Germany, Belgium and Sweden, the postal cheque and giro system accounts for a considerable part of the payments transactions.

United Kingdom

In the United Kingdom, a different situation applies. Here, the conventional concept of banking as a form of short term and self liquidating credits is still strongly adhered to. However, changes have become more distinct in recent years.

Differences between British, American and Continental banking are to a large degree the result of historical factors. Britain was the first country to industrialise, and did not lack the resources with which to finance this development. It was made possible by the wealth and prosperity she enjoyed on account of her prominent position. Traditionally, British industry obtained its capital through self finance, from private sources or by means of public issues. Bank finance, in this sphere, played a subordinate rôle. There was also an early tendency towards specialisation in the financial sphere. Once this development had reached an advanced stage, it became, as always, difficult to break with accepted practices and policies.

This promoted the growth over the past 100 years of a variety of financial institutions providing the requirements of all sections of industry, commerce and finance. Amongst these institutions are the old established merchant banks, traditionally providing finance for imports and exports, but also financing trade between third countries and latterly delving into the medium term loan market; acceptance houses, often associated with merchant banks, specialising in and underwriting large share issues as well as doing normal merchant bank business; shippers, financing exports from the United Kingdom to various countries; discount houses, which are really the short term bankers of the commercial banks. It is interesting to note that in the United States the large commercial banks in New York, Chicago and San Francisco really act as discount houses for the various domestic banks throughout the states.

But even in this environment of tradition, changes in British attitudes have recently become more pronounced. There is evidence of awareness by the commercial banks of the need to provide financial assistance for longer periods, whether for industrial, export or other purposes. This is mainly occasioned by the fact that the commercial banks did not wish to lose too much valuable business to the other financial institutions and thus now compete to some extent in the medium term finance market.

Nevertheless the British banking system still differs basically from that of America and Europe in that the commercial banks do not seriously compete for time deposits and limit themselves normally to taking moneys with seven days' notice only. British bankers may well have feared the cost of competition and they may have believed that ultimately they would be left with the same deposits attracted at a higher price.

These observations explain the reluctance of the commercial banks to increase their longer term lendings. Nevertheless the range of services they offer has been extended considerably in the past few years. Personal loan schemes have been introduced, under which repayments are made by fixed monthly instalments over periods of up to two years and credit cards have been issued by some of the clearing banks, thus following the lead of the American banks in this field.

Medium term lending by the British commercial banks has increased. They have participated in the Insurance Export Finance Company Limited, and provide longer term export finance. The clearing banks also have considerable interests in hire purchase finance institutions.

In addition, British banking is being automated at a rapid pace, through the increased use of computers, to check rising costs of labour.

All the banks combined have arranged to make their credit transfer service (which operates through a central credit clearing) available to all banks and even to noncustomers. The latter move reflects the banks' concern over the proposed introduction in England of a national giro system to be operated by the Post Office.

It is significant that, from the end of 1962 until the end of September last year, deposits with domestic banks in the United Kingdom rose by 18% to £10.6 billion, while deposits with overseas banks in the United Kingdom more than doubled to £4.2 billion. Deposits with American banks in the United Kingdom, in particular, increased rapidly, from £450m. to over £2,000m. The overseas banks are, of course, not subject to the agreements on fixed deposit rates between the London clearing banks, and they are very active in the London market in Euro dollars—dollar deposits with banks in Europe.

Although not strictly financial institutions in the sense that I have been talking the building societies movement in the United Kingdom has grown to enormous proportions, and is definitely a factor to be considered in the general financial structure. These societies gain their impetus from the fact that British banks have never been prepared to provide long term mortgage funds, while the demand for such funds has been created by the large scale developments of industry in the country over the past 50 years, as well as the increase in the population and the standard of living.

Southern Africa

Undoubtedly the most developed country economically is the Republic of South Africa. Broadly, changes in banking there have been similar to those in the industrialised countries of Western Europe and the United States of America.

Nowhere on the African continent has the shift from a predominantly agricultural and mining society to a more industrialised economy been so prominent as in the Republic. These changes in the economic sphere have had to be matched by greater efforts to mobilise idle funds and to create a more active money and capital market in which the forces of supply and demand could be more effectively transmitted throughout the financial system.

The old established commercial banks, Barclays, Standard and Netherlands, were joined in the 1940s, 1950s and 1960s by Volkskas and a number of foreign backed commercial banks—the French Bank of Southern Africa, South African Bank of Athens, First National City Bank of New York, Chase Manhattan Bank, which later amalgamated its South African offices with the Standard Bank and the Bank of Lisbon and South Africa. Moreover, a number of merchant banks and discount houses were established, which contributed to the development of a more active money market in South Africa.

In the medium term credit field there was a considerable growth of hire purchase and other consumer credit companies (e.g. the Trust Bank of Africa) all of which demanded their share of the pool of money.

In this environment the commercial banks could not afford to adopt a passive attitude. As the demand, particularly for longer term industrial finance, grew, the commercial banks began to compete actively to attract longer term funds. This is evinced by the fact that they now hold about 50% of their credit moneys in the form of fixed and savings accounts, whereas just after the war this figure was 14%.

In an effort to diversify their interests, the commercial banks also participated in the share capital of hire purchase and industrial finance companies. This trend found its logical conclusion when banks such as the Netherlands, Volkskas and Standard Bank, formed their own subsidiaries, designed to attract a pool of funds from which loans could be provided on terms normally falling outside their usual sphere of lending.

However, on the basis of a greater volume as well as a more balanced assortment of credit moneys, the advances and discounts of the commercial banks in South Africa rose from R185m. in 1946 to R622m. in 1958 and R1291m. at the end of last year. The bulk of these loans were for manufacturing industry, commerce and agriculture.

Although the commercial banks, therefore, succeeded in maintaining a predominant position in the provision of funds to the various sectors of the economy, it must be noted that the percentage of their deposits in relation to the gross national product has, with minor fluctuations, declined since 1946. This must be seen against the background of the Banking Act 1942 which singled out the commercial banks for monetary control: in addition, their lending rates were obliged to follow changes in the official bank rate. These regulations impaired the ability of the commercial banks to compete for deposits on equal terms with other financial institutions.

However, new banking legislation, fully embodying modern thought, namely that all banking institutions perform essentially similar functions as intermediaries between borrowers and lenders, was introduced in South Africa at the beginning of last year.

Without going into details, it may be said that the new banking legislation will, to a large extent, achieve the more equal treatment of the various financial institutions competing in similar fields in South Africa.

Another important development in the Republic is the establishment of mutual funds or open end trusts. These new funds sell units, representing part of their diversified share portfolios, to the public and undertake to repurchase them if requested by the unitholder. The first in the field was the South African Growth Equities Fund (SAGE Fund) which was constituted in 1965. It was soon followed by a number of others, and they have already made considerable headway. These funds compete for the savings of individuals and companies and could develop into strong rivals of established savings institutions, such as the building societies and, possibly, the banks. Sponsors and shareholders in the management companies of the open end trusts include life insurance companies and banking institutions.

Rhodesia

Turning now to our own country, Rhodesia, we find the pattern of development of the whole banking industry very similar to that of South Africa, although both the scale and the timing has, for obvious reasons, been different. In the first place Rhodesia started its industrial development much later than the Republic, while the scope of this development is relatively much smaller. This does not mean however, that the strides which have been made, particularly in the past 25 years are not outstanding. Even a little over 10 years ago the only financial institutions of note operating in this country were commercial banks.

In 1955 the total demand deposits of the commercial banks amounted to about £50m. which was approximately 90% of total deposits—exact figures for Rhodesia are not available as all statistics were Federal. By 1965 the total demand deposits still stood at approximately the same figure, but represented only 63% of total deposits. On the other hand savings and time deposits had risen from £4m. to over £25 m., representing 35% of total deposits which had risen from about £55m. to £77m.

During this ten year period the merchant banks had however, come into the picture with deposits now of around £5m. to £6m., while other financial institutions had attracted nearly £4m. The most notable newcomers, from the point of view of attracting credit money, were the building societies, which in 1955 held total deposits of £8m. and in 1965 £23m. Other notable newcomers were the discount houses the first of which started in 1960 and which together at the end of 1965 had total deposits of over £12m. These deposits came notably from the commercial banks and represent part of their surplus funds.

I thought it best to indicate first the pattern of statistics as regards Rhodesia, as these clearly indicate the trend particularly of post war years. At the beginning of this period only three banks were operating here and between them they provided practically the entire financial requirement of the economy. Although they paid lip service to the British tradition of borrowing and lending only in the relatively short term, much of the lending was really of a longer term nature. This could be endured when the demands of industry were relatively small but with the industrial development that took place in this country particularly in the fifties the situation had to be watched more closely especially as with the development of a Central Bank the banks' figures came under closer scrutiny. Growth of the building societies enabled the banks to avoid longer term lending for building, while the availability of overseas finance, notably from the U.K. and South Africa, assisted the banks in keeping their lending portfolio reasonably short and liquid.

However in the sixties circumstances have changed considerably, partly for political reasons and partly because of a general world wide shortage of money, and development in Rhodesia has had to lean to a large extent for its financial requirements upon local financial institutions. But for the slowing down in Rhodesia's economy, occasioned by political circumstances this problem would have become acute quite some years ago, but the fact that a temporary respite, however unwelcome, has been granted should not permit the banks of this country to become complacent, for the time will undoubtedly come when large scale development will again begin and the demands on the financial institutions of the country generally will then be very great.

Some beginnings have been made and here I refer particularly to the establishment in Rhodesia some two years ago of a medium term industrial credit corporation under the name of the NEFIC. This company which borrows in the longer term, offers finance for industrial development in the medium term. The company is in fact owned by the Netherlands Bank and has operated for some years in South Africa and it is hoped that its development in Rhodesia will match that which has been accomplished in South Africa in the past five years.

However, the need for medium term finance will undoubtedly become acute once some clearance has been found to the present political and constitutional impasse, and undoubtedly with the best efforts in the world it will not be possible to do all that we want to do with local funds. We shall need overseas investment and this is one reason why it is essential that we must maintain, notably with large financial institutions throughout the world, the good name and high integrity which Rhodesia has earned in the past. We must not allow the current economic war being waged against us to spoil our good name and we must continue to show that our credit is of "A1" standing. But even if we do succeed in attracting substantial overseas investment we shall still have to make our economy generate as much local finance as possible. This will mean the building up of financial institutions which specialise in all forms of finance, and perhaps also an all out attempt by the commercial banks to lengthen the terms of their borrowings and thus be able to provide loans in the longer term.

We shall have to make our available funds work harder and faster which can be accomplished by more efficient operation not only of the banking industry but also of commerce and industry.

All of this is a great challenge not only to the banks but also to the industrial and commercial sectors but if we can approach it in the same spirit and with the same determination as we have attacked the problems posed by sanctions during the past two years, then I have no doubt that the challenge will be met. While the relative growth of the banks and other financial institutions in the past few years has been spectacular, we must never forget that we are only on the threshold of the real development of Rhodesia and we must only be encouraged by our past successes and realise that it will be a very long time indeed before any of us can safely rest upon our laurels.

The Netherlands Bank of Rhodesia Limited,
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